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August 2, 2021

Via Electronic Submission

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street Constitution Avenue, NW
Washington, DC 20551

RE: Docket No. OP-1749—Potential Modifications to the Federal Reserve Policy on Payment System Risk to Expand Access to Collateralized Intraday Credit, Clarify Access to Uncollateralized Credit, and Support the Deployment of the FedNow Service

Dear Ms. Misback:

The Independent Community Bankers of America (“ICBA”)¹ welcomes the opportunity to provide comment to the Board of Governors of the Federal Reserve System (“Board”) on proposed changes to part II of the Federal Reserve Policy on Payment System Risk (“PSR policy”) that would expand access to collateralized intraday credit from the Federal Reserve Banks (“Reserve Banks”) and clarify the eligibility standards for accessing uncollateralized intraday credit from Reserve Banks. In addition, the Board is requesting changes to part II of the PSR policy to support the deployment of the FedNow Service. Relatedly, the Board is proposing to incorporate the Federal Reserve Policy on Overnight Overdrafts (“Overnight Overdrafts policy”) into the PSR.

¹*The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. ICBA is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education, and high-quality products and services.*

With nearly 50,000 locations nationwide, community banks constitute 99 percent of all banks, employ more than 700,000 Americans and are the only physical banking presence in one in three U.S. counties. Holding more than \$5 trillion in assets, over \$4.4 trillion in deposits, and more than \$3.4 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers’ dreams in communities throughout America. For more information, visit ICBA’s website at www.icba.org.

The Nation’s Voice for Community Banks.®

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Executive Summary

ICBA remains a consistent and vocal supporter of the Federal Reserve taking steps toward a faster, safer, and more efficient payment system. In past comments,² ICBA strongly applauded the Reserve Banks for recognizing that faster payments should be a priority for all financial institutions and urged the Reserve Banks to act quickly toward this goal. ICBA encourages the Board to continue to identify and propose PSR policy changes to bring to market an instant payment service more rapidly and to foster wider adoption. At the same time, ICBA stresses the importance of providing solutions, including the FedNow Liquidity Management Tool (“FedNow LMT” or “LMT”), that can equip and bolster community banks’ preparedness for the dynamic new 24x7x365 environment.

Background

The PSR policy is intended to foster the safety and efficiency of payment and settlement systems. Originally created to govern the Fedwire Service, the PSR policy will be expanded and updated to support the new FedNow Service. The set of proposed rule amendments include:

1. Clarifying terms of access for uncollateralized intraday credit from the Federal Reserve Banks,
2. Reducing restrictions over accessing higher levels of intraday credit via collateralization,
3. Reducing the administrative burden of collateralized intraday credit, and
4. Aligning the PSR policy for uncollateralized intraday credit and overnight overdraft policy with the launch of the FedNow Service.

ICBA Comments

ICBA is generally supportive of the elements in the proposal and believes that the contemplated changes are reasonable, will simplify processes, and create flexibility in maintaining access to intraday credit for community banks’ liquidity planning and risk management efforts. However, ICBA stresses our concern with the absence of information regarding notable features in the FedNow LMT proposed at launch of the FedNow Service, and the potential for payment system risk due to the lack of clarity related to the 24x7x365 operational environment at this time.

Please see additional comments and concerns:

² See Phillips, Deborah, “[Docket Number: OP–1670] Service Details on Federal Reserve Actions to Support Interbank Settlement of Instant Federal Reserve Actions to Support Interbank Settlement of Faster Payments,” Sept. 10, 2020: https://www.icba.org/docs/default-source/icba/advocacy-documents/letters-to-regulators/icba-fednow-comment-letter.pdf?sfvrsn=92823917_0.

A. Expanding Access to Collateralized Capacity

ICBA supports the proposed amendments to the PSR policy related to access to collateralized capacity. The risk-based approach offered by the Board in expanding the pool of institutions eligible to request collateralized capacity is logical and prudent. In view of these changes, ICBA further asks for clarifications in the following areas:

- **Collateralized Capacity** – Given the trend in bank consolidations and considerable time since the net debit cap multiples were adjusted,³ we recommend revisiting the segmentations. Reviewing and revising the cap categories is appropriate after FedNow matures when significant volume has been processed through the system, and insights can be gathered from a 7-day accounting and monitoring regime.
- **Collateral Type** – The distinction between the different types and quality of collateral (e.g., loans, securities, etc.) that can be pledged to the Fed discount window and their associated impact on the maximum daylight overdraft capacity (“max cap”) is unclear. It would be valuable to provide community banks this information when they pledge collateral to secure collateralized daylight overdraft capacity or uncollateralized capacity from its net debit cap.

Relatedly, ICBA appreciates reducing the administrative steps associated with requesting collateralized capacity. ICBA concurs with the Board that the proposed changes would lead to additional efficiencies and minimize the burden on financial institutions.⁴ Specifically, we support eliminating the requirements of a written business case for their Reserve Banks when requesting collateralized capacity and an annual Board of Directors’ resolution approving requests for collateralized capacity. Historically, many smaller bank entities have not asked for collateralized capacity with the Federal Reserve. With the forthcoming 24x7x365 environment and as transaction levels increase, there is value in the expanding access to collateralized capacity as community banks may need collateralized intraday credit or need to mitigate overnight overdraft exposure in their Federal Reserve accounts.

B. Clarifying Access to Uncollateralized Capacity

The revised PSR policy introduces new details of when an institution can request and maintain uncollateralized intraday credit capacity. ICBA supports the Board’s clarifying terms, simplifying eligibility criteria, and incorporating the informative table into the PSR policy for when institutions can request a positive net debit cap. Further, ICBA believes the Board’s measures to reflect the impact of an institution’s holding company’s or affiliate’s

³Information was last updated on August 02, 2013:

https://www.federalreserve.gov/paymentsystems/psr_overview.htm.

⁴Fed. Reg. Volume 86, Number 105, June 3, 2021.

low supervisory rating on the institution's eligibility is reasonable from a safety and soundness standpoint.

C. Changes to Support the Deployment of the FedNow Service

The Board proposes amendments to align the PSR policy and the Overnight Overdrafts policy with the deployment of the FedNow Service and address changes associated with a 24x7x365 payment environment. ICBA agrees with the Board's proposed revision to incorporate the Overnight Overdrafts policy as part III of the PSR policy as it would underscore the close relationship between daylight overdrafts and overnight overdrafts in an institution's account. Nevertheless, ICBA has deep concerns specific to the lack of information and features, detailed below, related to the FedNow LMT. ICBA urges the Board to consider the impact of 24x7x365 operations on community banks.

Liquidity Management Tool

Participating in a real-time payments system increases intraday liquidity needs as sufficient cash must be held to fund outbound payments before incoming payments settle. To this end, ICBA appreciates the Board providing the FedNow LMT as an initial core feature of the FedNow Service. While this is welcomed, at present there is a lack of detail and features related to LMT. Specifically, given the evolving liquidity needs, banks will require sophisticated intraday liquidity management and cash flow forecasting capabilities to operate in the new environment effectively. An issue of concern raised by ICBA bankers' bank members is the LMT proposal for access by their customer banks (i.e., respondent banks). Respondent banks can make calls to correspondent banks' master accounts without any level of control by the correspondent bank, which is problematic. An added challenge is correspondent banks and aggregators cannot manage aggregate transaction amounts. They can only review at the transaction dollar amount level. ICBA stresses the importance and value of the Federal Reserve offering more information regarding LMT features prior to the initial rollout to adequately prepare financial institutions.

24x7x365 Operations

The FedNow Service will be designed to maintain uninterrupted 24x7x365 processing. The service will have a 24-hour business day each day of the week, including weekends and holidays. End-of-day balances will be calculated for each day of the week, with transactions occurring on weekends and holidays recorded in the same way as transactions occurring Monday through Friday. The continuous, 24-hour nature of the FedNow Service will require community banks to adjust internal account monitoring practices to manage liquidity and fraud concerns. The Federal Reserve has indicated that it does not want to be prescriptive in the methods and models of reconciliation through the 24x7 period. ICBA strongly urges the

Federal Reserve to reevaluate its position and provide tools and templates to appropriately prepare community banks for the impact of the 24-hour business day and accounting changes.

A key aspect for financial institutions to manage and maintain the right cash position and liquidity is reconciliation. The Federal Reserve has conveyed that only balance information will be available from the FedNow Service. Participating community banks actively engaged in the FedNow pilot stress the importance of detailed electronic transaction reporting to address potential risks arising from the 24x7x365 transaction processing and settlement. ICBA strongly requests the Federal Reserve to explore balance reporting detail with the FedNow Service to facilitate reconciliation and early detection of issues, including potential fraudulent or illicit activities.

Crucially, ICBA bankers' banks play a vital role in aiding community banks with liquidity management. Our member correspondent banks have expressed they are an integral player in eliminating or minimizing risk at the Federal Reserve and are concerned that they are taking on added risk, especially in the off-hour environment. The ability of participants in the FedNow Service and their agents to access and manage funding during the end-of-day cycle and provisional timeframes period (i.e., after-hours, weekends, and holidays) will be important in avoiding overdrafts of the bank's master account at the Federal Reserve. Correspondent banks will absorb a high degree of risk in managing master accounts with 24x7x365 settlement activity and providing a larger asset liquidity scale. Lack of controls to moderate the velocity of payment flows over their master accounts and offer greater certainty about their balance could pose payment system risk with downstream implications. The FedNow Service Readiness Guide notes, "Participants should not expect the FedNow Service, at initial launch, to reject payments based on a participant's insufficient balance or overdraft capacity, even if the Federal Reserve Banks do so for other services. However, standard intraday and overnight overdraft fees will apply."⁵ System participants could be materially impacted by overdraft fees and other economic ramifications resulting from the unpredictable volume of transactions with the new service (although anticipated to be low at the beginning), combined with the inability to reject transactions.⁶

⁵The Federal Reserve Financial Services. "FedNow Service Readiness Guide." June 2020.

⁶ Generally, there should not be an issue with overdraft fees at the consumer/end-user account holder level. However, in the scenario if/when the front-end controls are not sufficient, there could be overdrafts at the consumer/end user account holder level given that FedNow Service does not intend to reject transactions initially. Further, there could be and more likely will be overdrafts at the participant financial institution and/or the correspondent settlement bank because the Federal Reserve is not allowing for proper settlement controls

D. Other Comments

ICBA recommends that the Board make the following accommodations:

- **Consider a grace period for daylight overdraft fee and penalty fees for FedNow participants as the FedNow infrastructure matures.** ICBA is encouraged by the Board's decision to establish a transparent fee structure. At the same time, ICBA urges the Board to examine the fee policy more closely. Community banks request a grace period as adjustments occur. With the new FedNow service, ICBA recommends that the Board eliminate or reduce penalties to encourage more and early participation of the FedNow Service while minimizing the economic impact to small entities.
- **Provide equitable overdraft pricing.** Under the proposal, the effective fees and penalty rates will increase broadly "to all institutions to reflect the 24-hour business day" with FedNow from the current 22-hour Fedwire Funds operating day.⁷ Organizations that are not participants in the FedNow initiative will unfairly incur a rate increase. ICBA asks the Board to maintain a streamlined fee scheme (e.g., elimination of multi-day charge for overnight overdrafts), but with a price structure that does not disadvantage other depository institutions.
- **Encourage a phased approach to policy implementation.** The Board notes proposed changes may become effective at different times. ICBA requests that consistent advanced communications accompany the phases so that community banks can prepare for each stage. In doing so, community banks will better understand each transition phase and ensure that appropriate testing, processes, and other necessary measures are in place. ICBA commends the Federal Reserve for this approach which will balance speed to market and the availability of instant payments functionality by participants.
- **Conduct an educational outreach.** ICBA suggests the Federal Reserve launch significant educational efforts to increase awareness of the FedNow Service to market participants, including highlighting potential concerns related to liquidity issues. To avoid liquidity risk, or worse, failed or overdraft transactions, the Federal Reserve should offer guidance to financial institutions. Providing best practices such as risk-based processes and controls and sample safe harbor language for bank customer disclosures will be essential for participating sending banks to implement in advance of the initiation of a transaction.
- **Expand the Fed service hours for Fedwire Funds Service and National Settlement Service (NSS).** As stated in past comment letters to the Board,⁸ ICBA reiterates that

that would otherwise mitigate such overdrafts or extensions of credit from occurring. This risk will be exacerbated in the off-hours.

⁷ Fed. Reg. Volume 86, Number 105, June 3, 2021.

⁸ See Phillips, Deborah, "[Docket Number: OP-1670] Service Details on Federal Reserve Actions to Support

extension of the discount window to accommodate evenings, weekends and holidays is a vital step toward payments improvement and should be a priority for the Board. Expanded hours for these services will bring broad benefits to public and private sector stakeholders as well as improve the payment settlement services for ACH, checks, and wire transfers. In light of the systemic importance of the Fedwire Funds Service and NSS, ICBA urges the Board to keep this workstream on an accelerated schedule.

ICBA appreciates the opportunity to provide comments on the proposed changes. While ICBA is encouraged by the Board's efforts to provide greater flexibility with liquidity and risk-management planning in the deployment of FedNow, ICBA urges the Board to consider the impact of the 24-hour environment on community banks and provide the tools needed to support this effort. ICBA looks forward to working with you to provide support in the process.

If you have any questions, please do not hesitate to contact me at Nasreen.Quibria@icba.org or (202) 659-8111.

Sincerely,

/s/

Nasreen Quibria
Vice President, Emerging Payments and Technology Policy

Interbank Settlement of Instant Federal Reserve Actions to Support Interbank Settlement of Faster Payments," Sept. 10, 2020: https://www.icba.org/docs/default-source/icba/advocacy-documents/letters-to-regulators/icba-fednow-comment-letter.pdf?sfvrsn=92823917_0.

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